Insurance Institute
of Michigan

Written Testimony
Presented by the Insurance Institute of Michigan
On the Regulation of Insurance Scoring Discounts
House Bill 4070
March 29, 2007

The Insurance Institute of Michigan (IIM) supports House Bill 4070, legislation that would allow insurance companies in Michigan to continue to offer premium discounts to policyholders with good insurance scores, but with appropriate controls to protect consumers.

The use of insurance scores as a factor in insurance decisions is not new. As early as 1970, the U.S. Congress approved the Fair Credit Reporting Act, which permits insurance companies to use credit information in making underwriting and rating decisions.

To make fair and objective decisions, insurance companies need to have as much information as possible. Insurance scores provide a consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers.

Insurance scores used by insurers are different than credit scores used by banks and other lending institutions. Insurance scores are developed from information contained in consumer credit reports. However, an insurance score provides a numeric assessment of an individual's insurance risk. It reflects credit payment patterns, length of credit history, types of credit and number of new applications for credit. Insurance companies consider only those items from credit reports that are relevant to insurance loss potential. Unlike a lender, an insurance company is not assessing a customer's income and debt, they are evaluating how a customer manages their finances and the credit granted to them. Information such as a person's age, income, ethnic group, religion, gender or marital status is not factored into insurance scores.

The use of insurance scores is a benefit to insurance customers. It helps allocate the cost of coverage based on a consumer's claim potential. Independent studies have proven a strong connection between insurance scores and the likelihood of an individual filing a claim. These same sources indicate that the use of insurance scores increases the fairness of insurance, allows many consumers to pay less for insurance than they otherwise would, and enables insurance companies to offer coverage to more consumers than they had in the past.

The use of insurance score discounts makes pricing more fair and allows insurance companies to offer lower rates by providing discounts to consumers who have proven to manage their finances well. People less likely to file a claim in the future pay less and those more likely to have a loss pay more. According to a May 1, 2004 *Detroit Free Press* editorial, "In truth, many Michigan policyholders – roughly 70 percent – get good credit discounts where offered. The share of customers getting such discounts in cities such as Benton Harbor and Detroit is the same as the rest of the state."

Insurance companies use insurance scores because it makes pricing more accurate. Combined with more familiar factors, such as years of driving experience, previous accidents, type of car or home, where you live or drive, and whether you have an alarm system, insurance scores allow insurance companies to more precisely differentiate between lower and higher insurance risks.

House Bill 4070 is based on a national model developed by the National Conference of Insurance Legislators (NCOIL) – the same national model that has been adopted by 26 other states. It would:

- Require insurance companies to disclose to consumers that credit information will be considered when determining insurance premiums;
- Allow policyholders to request a review of their insurance score at the time of their annual renewal;
- Require insurance companies to re-score a person who has successfully challenged an error in their credit history; and
- Prohibit insurance companies from using the following as negative factors in insurance scores: credit inquiries not initiated by the consumer, credit inquiries related to insurance coverage, collection accounts with medical codes, and multiple mortgage and automobile lending inquiries.
- Require an adverse action notice with reason codes providing consumer with information on how to improve their scores.

In Michigan, the Office of Financial and Insurance Services (OFIS), the state regulator of insurance, attempted to implement a rule that would ban the use of insurance scoring in this state. That rule was challenged by the insurance industry. A circuit court judge ruled that OFIS did not have the authority to ban insurance scoring through an administrative rule. That decision is now being appealed by OFIS in the Michigan Court of Appeals.

Prohibiting the use of insurance scoring would have a detrimental impact on policyholders. In Maryland, policyholders faced double-digit percentage increases in their homeowners insurance because of a 2002 state law that banned the use of insurance scoring in homeowners. In Oregon, voters defeated a ballot proposal last November by an almost 2-to-1 margin that would have prohibited the use of insurance scoring in that state.

Using insurance scores as criteria for rating is within the scope of Michigan insurance laws and the Fair Credit Reporting Act. House Bill 4070 would continue to allow insurance companies to offer discounts while addressing concerns raised by consumers.

Q & A ABOUT THE USE OF INSURANCE CREDIT SCORE DISCOUNTS IN MICHIGAN

What does a person's credit history have to do with home and auto insurance?

Independent studies have proven a strong connection between certain factors in an individual's credit history, as calculated into an insurance score, and the likelihood of an individual filing a claim. People who use credit wisely are generally responsible in other areas of their lives. Research indicates that people with better insurance scores have fewer losses and less expensive claims.

What is an insurance score discount?

Insurance scores are different from credit reports or scores used by lenders. Insurance companies develop insurance scores from certain credit history information contained in credit bureau reports and use the information when making rating decisions. An insurance score provides a numeric assessment of an individual's insurance risk. It reflects credit payment patterns, outstanding debt, length of credit history, types of credit and number of new applications for credit. Insurance companies consider only those items from credit reports that are relevant to insurance loss potential. Unlike a lender, an insurance company is not assessing a customer's income and debt, they are evaluating how customers manage their finances and credit granted to them.

Why do insurance companies use insurance scores in pricing?

To make fair and objective underwriting decisions, insurance companies need to have as much information as possible. Insurance scores provide a consistent and effective tool to evaluate risk that does not discriminate against any specific group of customers. Information such as a person's age, income, ethnic group, religion, gender or marital status is not factored into credit-based insurance scores.

Why don't insurance companies just look at driving records or claims history?

Most people think that insurance companies can obtain all the information they need from state motor vehicle departments. However, a recent study by the Insurance Research Council (IRC) indicated that one in five traffic violations may not appear on a Motor Vehicle Record (MVR). Credit information is generally more accurate and compliments driving history to work to the advantage of most policyholders.

How does the use of insurance score discounts benefit insurance consumers?

The use of insurance scores actually allows insurance companies to offer lower rates by providing discounts to consumers who have proven to responsibly manage their finances.

What would happen if insurance companies could no longer provide a discount based on credit information?

If insurance scores are no longer used as a factor for discounts, consumers who have a lower potential for loss would experience an increase in premiums.

Do all insurance companies use insurance scoring in their rate making?

Most insurance companies do use insurance scoring. However, consumers can access a list of insurance companies that do and don't use insurance scoring at the Michigan Office of Financial and Insurance Services website, *www.michigan.gov/ofis*.

Can a consumer be denied insurance based on their insurance score?

In Michigan, state law prohibits consumers from being refused insurance based on their credit information. Insurance companies here may, however, offer a discount for good insurance scores.

How is a consumer's privacy protected?

Access to specific credit information is very limited. Most insurance companies only see the score, not the information that went into developing it. All companies must follow the Fair Credit Reporting Act and state laws that apply to the use of credit information. These measures ensure there is confidentiality, accuracy and a legitimate need for the information.

Are insurance scoring discounts reliable?

The Consumer Data Industry Association reports that less than 1 percent of all credit report challenges result in a change once the inquiry has been fully investigated. Studies have found that credit reports are more reliable than motor vehicle records.

How can consumers find out about their insurance score discount?

The use of insurance scores is not secret. Every existing and potential policyholder deserves to know how a company uses credit information. If you don't feel your agent or company is telling you what you need to know, shop around for another agent or company that will.

What can consumers do to improve their insurance score?

Consumers can improve their insurance scores over time by using credit responsibly. Make sure you pay bills on time, keep balances low and apply for and open new credit accounts only as needed.

It is also a good idea to periodically obtain a copy of your credit reports from the three major credit bureaus to check for any inaccuracies. These are available free once a year by visiting, *www.annualcreditreport.com* or calling 1-877-322-8228.

Can consumers ask to have their insurance score recalculated if they improve their credit?

Yes. At the request of the policyholder, a company will rescore at least once annually.

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